

Almunia, Joaquín; Mendes de Azevedo, Belmiro; Heller, Peter S.; Lindbeck, Assar;  
Posen, Adam S.

## Conference Paper

# How globalization transforms the welfare state

Session Handouts, Global Economic Symposium 2008 (GES), 4-5 September 2008, Plön Castle,  
Schleswig-Holstein, Germany

### Provided in Cooperation with:

Kiel Institute for the World Economy – Leibniz Center for Research on Global Economic Challenges

*Suggested Citation:* Almunia, Joaquín; Mendes de Azevedo, Belmiro; Heller, Peter S.; Lindbeck, Assar;  
Posen, Adam S. (2008) : How globalization transforms the welfare state, Session Handouts, Global  
Economic Symposium 2008 (GES), 4-5 September 2008, Plön Castle, Schleswig-Holstein, Germany,  
Kiel Institute for the World Economy (IfW), Kiel

This Version is available at:

<https://hdl.handle.net/10419/79089>

#### Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen  
Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle  
Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich  
machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen  
(insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten,  
gelten abweichend von diesen Nutzungsbedingungen die in der dort  
genannten Lizenz gewährten Nutzungsrechte.

#### Terms of use:

*Documents in EconStor may be saved and copied for your personal  
and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to  
exhibit the documents publicly, to make them publicly available on the  
internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content  
Licence (especially Creative Commons Licences), you may exercise  
further usage rights as specified in the indicated licence.*



## Social Insurance: Promoting Health and Welfare

# How Globalization Transforms the Welfare State

### Summary

Does the new wave of globalization require a reconstruction of welfare state provision and financing? How does globalization affect the welfare state? Does it reduce governments' ability to impose taxes, while simultaneously creating more need for welfare state protection? Or does it benefit most segments of society, making welfare state protection less important with the passage of time? What are the policy implications?



What policies enable countries to reap the benefits from globalization while providing minimum levels of economic security, necessary to keep the citizens from voting for strongly protectionist policies? What constellation of welfare state policies enable us to compensate the losers from globalization without harming incentives to work and acquire skills? How can business contribute to the economic security of its employees without losing its customer focus? What policy environment would enable business to help contribute to social protection?

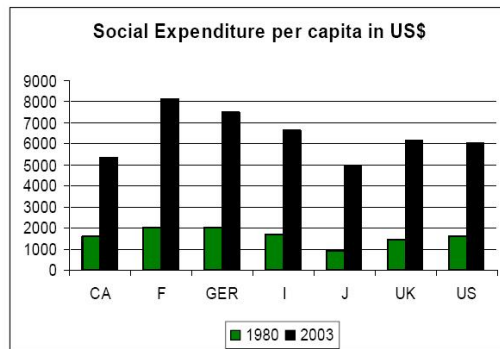


Figure: Social Expenditure per Capita in US\$ of G7 countries  
Source: OECD Social Expenditure Database

demographic factors:  
population aging

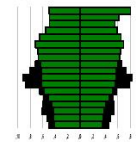


Figure: Germany 2000 vs 2050  
Source: OECD Population Pyramids

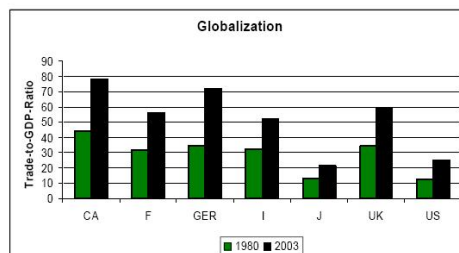


Figure: Globalization measured as Trade-to-GDP-Ratio of G7 countries  
Source: OECD Macro Trade Indicators Database





## **Proposed Solutions**

### **Expert Opinion**

#### ***Supporting the Losers from Globalization***

The globalization process creates winners and losers. Democratically elected governments must ensure that the losers can count on a social safety net and that their numbers remain limited. However, a traditional welfare state safety net may destroy incentives to adapt to globalization and thereby forego the gains to be had from rising flows of goods, financial assets, people, and ideas. Therefore, the challenge is to design a social safety net that is compatible with adaptability, so that the losers from globalization can turn themselves into winners through their own efforts.

This perspective implies a new way of thinking about social insurance. In the old policy paradigm, people's skills and job definitions are taken as given or gradually adjustable at best, so it appears to be the job of the welfare state to provide automatic stabilizers that support the losers of globalization. In the new policy paradigm, people are held to be more adaptable and versatile, so they themselves can become part of the automatic stabilization process by their own choices of jobs and skills.

#### ***Personal Accounts***

The basic individual tradeoff between increased exposure to globalization and social security would generate strong incentives in favor of adaptability if the substantial risks of life were organized in personal account systems (unemployment accounts, pension accounts, etc.). Personal accounts would reduce moral hazard problems by granting individual ownership rights and they would give individuals greater discretion in tailoring benefits to their own tastes.

An account system could be organized by private sector companies, with governmental institutions taking care of the required distributional element within the account system. Given the important role of private financial institutions in an account system, it has to be made sure that an appropriate regulation and suitable legal frameworks are implemented to protect the rights of participants.

#### ***Hiring Vouchers***

In addition, governments should put more emphasis on active rather than on passive labor market policies. Active labor market policies aim at increasing labor force participation and employment rates. Hiring vouchers appear to be one possibility among many. For instance, by using part of the unemployment benefits for a temporary wage subsidy, hiring vouchers may ensure that those who are most hurt by globalization are enabled to find alternative employment opportunities by their own efforts. In contrast to traditional passive labor market policies, hiring vouchers can be expected to increase the adaptability and versatility of workers at all skill levels.



## Strategy Perspectives

### ***Some Ideas About “How Globalization Transforms the Welfare State”***

Joaquín Almunia

*Commissioner for Economic and Monetary Affairs, European Commission*

- Globalization creates better growth and employment opportunities but also inequalities. Together with technological change increases mobility and less stable professional careers. Free movement of capital gives incentives to lowering direct taxes and put limits to progressive tax systems. Ageing puts additional pressure on public finances. Taking into account all these elements, financing the welfare state requires some important changes. Employability – increasing the human capital stock of each individual – becomes more important than passive unemployment protection. Life long learning is of the essence, to update and adapt the initial formation provided by the educational system. Life cycle is changing: entrance in the labour market takes place later and the retirement age is postponed accordingly, given the extension of life expectancy.
- The idea of personal accounts can be consistent with the changes mentioned above. But in this field market failure is a real risk, so I would suggest to analyse very carefully the social consequences of using this instrument. If not, we can add new inequalities to those created by globalisation.
- The idea of "hiring vouchers" seem to me an attractive way to promote active labour policies and eliminate negative incentives to work. Being Spanish Labour minister in 1984 I launched a scheme based upon this idea, that I think offered good results.

### ***Globalisation and Europe’s Social Model: Challenges and Policy Responses***

Joaquín Almunia

*Commissioner for Economic and Monetary Affairs, European Commission*

#### ***Introduction***

The integration of emerging Asian economies, such as China, India, and others, and of the former communist countries in Central and Eastern Europe into the world economy has added roughly 1.5 billion workers to the global workforce, putting pressure on the remuneration and employment perspectives of workers in the developed world, particularly the low-skilled. The mobility of capital and, increasingly, skilled workers has led to fears that redistributive policies are becoming increasingly restricted. These developments have raised questions about whether the European “social model” with its high levels of equity, insurance and social protection paid for by high tax burdens, can and should be maintained. I will argue that the answer to both questions is “yes”, provided appropriate policies are put in place.

#### ***The Opportunities of Globalisation***

Globalisation entails an increasing international division of labour. Countries specialise in what they can do best, and the principle of comparative advantage indicates that this is mutually beneficial. Increased economic integration also implies increased competition, a faster pace of innovation and technology adoption, and the realisation of economies of scale. Consumers profit from a larger variety of products and lower prices of goods and services. The increased international flow of capital and labour improves the allocation of resources and results in faster technology diffusion. In the developing world, in particular in China, India



and other emerging Asian economies, globalisation has enabled a reduction of extreme poverty at an astonishing rate. Never before have so many in such short time escaped from poverty as in the last 2 decades.

### ***The Challenges of Globalisation for European Social Models***

Accelerating globalisation poses policy challenges to our European social model. This model is based on a broad consensus amongst Europeans that there should be a relatively high degree of equity in our societies, that major risks should be insured, that poverty should be avoided and the risk of falling into poverty minimised. This consensus holds even though Member States differ substantially regarding the extent of state intervention in the market, the institutional framework of their pension systems, their health and long term care systems, the set of labour market institutions and the nature of the social dialogue, the design of family policies and so forth.

Challenges to the European social model stemming from globalisation may be roughly grouped into three. First, globalisation implies an accelerated reallocation of labour between sectors and firms. Second, globalisation, along with skill-biased technological change, puts pressure on the distribution of income, adversely affecting low-skilled workers in particular. Third, and finally, European governments need to secure adequate financing for social spending. With increasingly mobile tax bases, tax competition can undermine the ability of a tax system to be used to tackle the adjustment costs arising from globalisation. In addition, and quite apart from the challenges posed by globalisation, the European social model will come under immense pressure in future years as a result of population ageing. European pension and healthcare system, many of which were designed 50 years ago, are no longer viable in view of current demographic trends and unless they undergo reform, will not be sustainable to support future generations.

### ***Policy Responses to the Three Groups of Challenges***

Let me start by the first challenge linked to globalisation, the need to accelerate the re-allocation of labour between sectors and firms. If Europe is to reap the benefits from the increased international specialisation and technological innovation offered by globalisation, flexible product, capital and labour markets are essential for it to easily move into new and more competitive activities. The problem is that, by moving into new activities and away from traditional ones, Europe's economies may leave some European citizens, especially its least-skilled citizens, with inappropriate skill sets to be able to get the new jobs available. In this environment, the first thing policy should aim to do is minimise the need for workers to change jobs. Tax reductions for low-skilled workers may be necessary to that end. But if workers must change jobs, then welfare states need to provide smarter social safety nets. Hiring vouchers, for example, could be envisaged whereby part of an individual's unemployment benefits are used as a temporary wage subsidy, eliminating disincentives to work by decreasing the cost of employment facing employers and thus encouraging them to employ more. Efforts should also be made to facilitate the training and reallocation of workers across sectors. Policies that foster human capital formation are of the utmost importance. The provision of good quality education will enable people to better seize new job opportunities in a changing economic environment. Furthermore, poverty risks, long-term unemployment and social inclusion are closely tied to individual education and acquired skills, which makes the argument for more comprehensive and systematic training all the more compelling.

What about the second challenge facing Europe in the context of globalisation – the pressure on the distribution of income? The risk posed by globalisation of rising income inequality and low-skilled unemployment deserves an adequate policy response because it is contrary to the nature of Europe's social model, but also because it risks acting as a deterrent to further



progress in the reform agenda for growth, adjustment and fiscal sustainability. Appropriate policies need to compensate globalisation's losers or, preferably, enable those citizens to share in the benefits of globalisation. An effective approach could be to ensure that workers' incomes are substantially protected whilst they are in transition from one job to another. The focus needs to change from providing job protection to the provision of security in the market place (with appropriate unemployment benefits and activation policies). However, such policies have to be undertaken whilst recognising that it is no longer affordable to continue the old policies of subsidising inactivity, which involved little or no requirement to actively seek and accept jobs. One operational way that such policies could be implemented is via so-called personal accounts giving individuals much more ownership or say about the way and the extent that they would like to be protected from substantial risks of life. However, market failure may undermine personal accounts, so their introduction could actually aggravate the potential adverse consequences of globalisation on inequality; care should therefore be taken about introducing personal accounts, and should only follow very careful analysis of their social consequences. In any case, however it is achieved, greater income security must be combined with policies that intensify job-seeking efforts. In addition, structural policies to improve the functioning of product markets would complement direct social policies by resulting in lower prices that benefit low wage earners in particular. Similarly, reforming and deepening financial markets improves access to credit, in particular for low wage earners. This reduces the need for government intervention and can help facilitate labour market reforms.

As for the third and final group of challenges, the problem of tax competition and mobile tax bases, Europe clearly needs tax systems that are appropriate in a globalised world. Such systems should rely more on tax bases that are less mobile. However, while labour is a less mobile tax base, it is already highly taxed and higher rates may create disincentives to work and increase unemployment. Consumption and environmental taxes are other possible tax bases that are not so mobile, but they may raise equity and inflation considerations in the short run which could arouse sensitivities in the current economic slowdown; nonetheless, they remain important long term options. Taxes on property and on bequests are additional alternatives that could be considered. But beside such adjustments to their tax structures, Member States need to improve mutual information exchange and increase their cooperation to avoid tax evasion and tax fraud. In addition, governments need to encourage people to work longer and be more active. High participation rates are key to the sustainability of our social protection systems. This requires a coherent set of policy measures providing appropriate financial incentives for people to work beyond current actual retirement ages in most Member States. Such measures would need to be complemented by policies that improve the employability of workers as they age, via lifelong learning, promotion of occupational health, and other activities of maintaining work ability.

The policies outlined above that are necessary to cope with globalisation are policies that Europe has already been pursuing in other contexts. Most notably, the Lisbon Strategy for Growth and Jobs, with its core of product, capital and labour market reforms, is the EU's comprehensive strategy to tackle the challenges set out in this paper. This important European policy framework was relaunched in spring 2005, and one of the reasons for that relaunch was precisely to enhance interaction between Europe's policies on social protection and social inclusion on the one hand and its policies for employment and growth on the other. In respect of labour markets, the Strategy integrates the Community's flexicurity approach; that is, it advocates policies that target the use of unemployment benefits and employment protection legislation in a way that makes labour markets more flexible by giving workers more security in return. Under the Strategy, Member States have received policy recommendations for reforms in labour, product and service markets deliberately aimed at facilitating adjustment capacity.



Microeconomic reforms require a stable economic framework, which is why sound macroeconomic policies also form a key pillar of the Lisbon Strategy. Fiscal and monetary policies that anchor stability have a direct bearing on lowering unemployment, mainly by reducing risk premiums on interest rates and the servicing of debt, thereby improving the conditions for investment and growth. Macroeconomic policies should be geared to promoting low inflation, particularly during today's difficult economic climate. For example, fiscal consolidation reduces the pressure on monetary policy and creates room for adjustment, without the need to restrict welfare spending. Sound budgetary policies are also a vital means to improve the long term sustainability of public finances in view of population ageing.

Another Community policy framework helping to cope with globalisation and its challenges for our social model is the Economic and Monetary Union. As laid out in the Commission's EMU@10 report, EMU has proved to be a great success and a cornerstone of dynamic economic development in Europe; EMU's stable macroeconomic framework and international currency has helped shield and absorb shocks coming from the global economy. Nevertheless, several challenges remain to further improve its functioning. In particular, the report stresses that European labour markets need to become more flexible to increase Europe's ability to cope with economic shocks. To that end, the report argues that reforming unemployment benefits could play an important role in enhancing the flexibility of Europe's labour markets by upgrading the role of the tax and benefit system to act as a shock absorbing instrument in EMU's institutional arrangements. Thus, policy requirements for EMU and sound social and labour market policies in a globalised world run largely in parallel and are mutually reinforcing.

### **Conclusion**

**Europe must modernise to ensure continued high quality education and health care, satisfactory jobs for all and adequate pensions. Modernisation will give the confidence to reap the benefits of globalisation.**

As the experience in a number of EU countries shows, provided the right incentive structures are in place, it is possible to ensure economic dynamism while maintaining comprehensive social protection systems. The trade-off between efficiency and long-term financial sustainability of welfare systems and equality is not inevitable. However, reconciling these objectives requires decisive political decisions and resolute action for implementing proactive and forward-looking reforms that contribute to employment and growth and lay the foundations for the long run viability of social protection models in the era of globalisation.

### **Strategy Perspectives**

Belmiro Mendes de Azevedo

*Chairman, Sonae Group; Chairman, Sonae Indústrias; Chairman and CEO, Sonae Capital*

#### **The Background for these Contributions**

The advent of globalization has strongly influenced the paradigm of the historically based Welfare State, driving its objective and politic guidelines towards a new path. The characteristics of such a new path have much to do with the latitude of empowerment of sovereign states and with their ability to determine social cohesion and prevent adverse social effects of global competitiveness.

Therefore, whereas on the one hand the role of the State and the legitimacy and effectiveness of social programs is one of the central aspects when dealing with the relationship between Welfare State and globalization, on the other hand, one should also ask if the



outline of a given social cohesion policy can be decided and implemented autonomously, taking only into consideration the particular *momentum* concerns and anxieties of a sovereign State.

Global competitiveness is also about competitiveness of States (or Federations). Modern States develop serious efforts to attract corporations and investment (notably through definition of attractive tax policies and incentives to foreign investment); but are modern States capable of being socially competitive as well? Do they have the ability to effectively make a difference, implementing aggressive policies leading to social cohesion and, therefore, preventing the emergence of the globalization losers?

The European Union (EU) can effectively be set as a sample of the much wider aspects being dealt with in this discussion panel. The efforts of the EU in sharing the benefits of globalization ought to be seriously considered and we can all learn with the definition of minimum social standards to be implemented through foreign policies, having the citizens, states and corporation as active agents of the dissemination of a sustainable globalization.

Can we affirm, definitively, that global competitiveness hinders the social program of the states, or should one leverage this new opportunity to redefine the focus on social security contributions?

These set of considerations based the following contributions for the discussion on How Globalization transforms the Welfare State.

### ***The Contributions***

#### ***1. Definition of Minimum Social Standards Based on Global Trade***

The definition of social policies and the implementation of social cohesion programs is not a stand-alone decision of a modern State. With the increasing perspective of the global citizen (the 21<sup>st</sup> century nomads), migration movements will tend to lead to harmonization at the level of social protection that the States are able to offer to their citizens. Either a very aggressive or a very loose set of social policies will lead to movements of citizens, trying to adjust to their particular needs, towards countries with more protective polices, which in term will create pressures leading to the failure of such a social model. The definition of a set of rules and principles that can achieve a balance between social protection demand and adapting to global competitiveness should be the route to follow. The experience of the EU can be the case-study, as it has dealt with the same problems (although in a smaller scale than the ones arising from this new paradigm), and should be the basis for discussion. The States and economic agents trading globally will play a major role as *crusaders* and *vigilantes*: promoting the harmonization and stressing the need to share globalization benefits, defining a minimum set of standards that may be applicable globally.

#### ***2. The Welfare State Versus The Welfare Sector. The Emerging Role of Private Corporations***

The new path of the Welfare State can strengthen the role of the private sector in the contribution for the social cohesion. On the one hand, social spending of national states will need to be focused on the actual globalization losers: with the step-in of the private sector, the universality paradigm of the welfare state would be strongly reduced, as only citizens without the ability to use these new-coming private services (health, education, work assistance...) would be the subject of State policies and support. On the other hand, the takeover of traditional welfare services and sectors by the private sector, in cooperation with national governments, would create new business opportunities and new global traders, thus generating wealth for private agents. In this already on-going process, the role of national





governments needs to be thoroughly assessed and redefined, as some particular hurdles to the step-in of the private sector are yet to be removed.

### 3. *Globalization Hinders Social Programs and Spending! Does it?*

Can one undoubtedly argue that global competitiveness affects negatively the development of social policies and government spending in education, healthcare and social security? The sample taken in approximately 100 countries between 1980 and 1999 has shown that economic cycles and the advent of globalization has neither directly nor exclusively influenced social spending. In fact, that sample has demonstrated that the different aspects of social programs respond differently to long-term characteristics of the economy, and therefore a direct cause could not be undoubtedly found in the interaction of these two factors. Furthermore, other aspects were also contributing to the variations in social spending, such as financial and market integration and political power patterns.

Political fragmentation, the level and consistency of implemented democracy and historical factors of one given country are, altogether, able to modify and influence social spending.

These contributions reflect a personal view on the interaction between globalization and welfare state, and should not be considered, in any event, as solutions. The particulars of this analysis take the discussion to a wider level: how can we leverage globalization to redefine the Welfare Sector?

### ***Globalization and the Welfare State***

Peter S. Heller

*Professor of Economics, Johns Hopkins University*

Before responding to the specific questions raised for this panel, I think it is important to highlight three points:

*First*, the tendency in thinking about this topic is to focus on certain aspects of globalization: the globalization of the world's labor market, such that low cost labor in low income and emerging market countries very much restrains wage demands and creates competitive pressure on labor markets in advanced countries; the potential for a "race to the bottom" on tax rates that at least may put limits on the potential for using certain tax instruments (particularly on capital goods) to mobilize government revenue; and the benign effect that integrating low cost labor into the global economy can have in restraining pressures for price increases. Yet there are other aspects of globalization that very much bear on this broader topic:

- the greater degree of interlinkage between economies, such that cyclical downturns in some of the larger economic blocs or unanticipated vulnerabilities in financial markets can impact on other economies much more substantially and quickly than in the past;
- that growth in large emerging market economies is creating important pressures on resources that is fundamentally altering the relative prices of key commodities, with important effects on production decisions across the world ; and
- that various real shocks can also quickly influence competitiveness in different sectors. All these aspects of globalization can also create sectoral adjustment problems and corresponding difficulties for many households that may require welfare-state type responses (at least of a social safety net nature) or affect the viability of current welfare state systems.



*Second*, it is difficult to focus on the impact of globalization in isolation from some other key structural factors that are influencing the possibilities for the welfare state. Most important, of course, is the impact of demographic trends, particularly the aging of industrial country populations due to reduced fertility and lengthening life expectancies. Even in the absence of the globalization, this demographic structural change would have required major adjustments in the welfare state. The effects of technology on costs in the medical sector is another factor that is having an impact on the design of the welfare state (though globalization may prove to contribute to ameliorating some of these effects).

*Third*, in addition to its effects on the welfare state of advanced countries, globalization will also affect how many middle-income and even some more advanced low income countries should approach the design of social safety net and social insurance policies. Competitiveness concerns and the experience of the industrial countries is likely to limit the generosity of new social insurance systems in these countries. Turning to the specific questions posed:

Does the new wave of globalization require a reconstruction of welfare state provision and financing? It is not the new wave of globalization that will force modification of welfare state provision and financing, but rather the combination of the globalization that has occurred to date and underlying structural trends – in particular demographic trends in the industrial countries, emerging market, and low-income countries. The former will continue to put pressure on countries in terms of level of tax rates and competitiveness of industry. The latter will render existing welfare state promises unsustainable.

How does globalization affect the welfare state? Does it reduce governments' ability to impose taxes, while simultaneously creating more need for welfare state protection? Or does it benefit most segments of society, making welfare state protection less important with the passage of time? What are the policy implications?

One facet of globalization – the greater intensity of competition and the globalization of labor markets that allows for low-cost labor to be integrated into global production processes--undeniably provides benefits to most segments of society through lower prices for imported goods and greater competitive pressures on domestic production. But this does not at all make welfare state protection less important over time – indeed, the latter need arises as much from relative income status within a society as it does from absolute income status. Globalization's effect on the welfare state – and this applies across industrial countries, recognizing the significant differences in the character of the welfare states that one observes – is several fold:

- It limits the capacity of countries to raise tax rates or to maintain high tax rates, given competitive pressures, particularly on the taxation of mobile factors of production – viz., capital.
- It provides pressure for a restructuring of tax policies away from taxes on factors (particularly payroll taxes) and toward general sales taxes as a means of limiting the impact on employment; in this regard, it thus also creates pressures for changing the financing basis of welfare benefits away from those that are employment-linked. In a similar vein, it creates incentives for a restructuring of welfare policies to those which are of a personal account nature – e.g., defined contribution pension schemes, personal medical accounts. In the above context, and as noted above, one cannot ignore that these fiscal effects of globalization on the welfare state are occurring at the same time as the forces of demographic change will be independently pressuring the costs of the welfare state in industrial countries. Limits on the capacity to raise taxes at a time of growing social insurance burdens – particularly those faced by PAYGO systems – will force reforms that both contain benefit growth and put pressure to ensure an adequate safety net for the poorest of the elderly population.



- Globalization, combined with rapid technological change, accentuates the competitive pressures faced by domestic producers, with several important effects – restraining the capacity of labor to realize wage gains, maintaining pressure on producers for a lean labor force, and increasing the risk of unemployment. If anything, this accentuates the importance of social safety net policies – welfare and unemployment benefits – as well as policies to facilitate the more effective functioning of labor markets.
- Another facet of globalization, which will only continue to be reinforced in the future, will be pressures for migration arising from the largely predetermined growth in the global labor force in coming years (despite the drop in fertility rates globally and the obvious aging of industrial country populations). Given the large disparity in incomes between aging industrial countries and less developed countries, and the labor force needs of industrial countries, pressures for migration will continue to be an important policy challenge in industrial countries. Such immigration pressures have been felt as a double edged sword by many industrial countries, providing some additional financial support for financially weak welfare systems but also raising questions as to the eligibility for benefits of these migrant groups.
- Globalization has also enhanced the uncertainty and risk faced by domestic producers to global market changes. The last year has illustrated powerfully the way in which critical global commodity prices can be affected by supply and demand shocks as well as by speculative forces in the capital market. The ripple effects of such shocks can be transmitted quickly to local production markets, whether in low income or advanced economies. Witness the impact of high oil prices on the competitiveness of a whole range of industries in the United States, creating pressures on both established social insurance programs (unemployment benefits) and for relief outlays outside the formal welfare structure. (As an aside, our formal definition of the welfare state does not normally include the provision of financing to shore up financial institutions or strengthen deposit protection schemes, etc.). Also note the uncertainty created for producers who have created global supply chains as the cost of transport has risen sharply, rendering business models involving decentralized production processes less efficient. Such pressures could lead to greater competitiveness of domestic producers, either in advanced countries or neighbouring countries whose labor costs may now be more competitive. The important point is that uncertainty may be heightened, increasing the returns to being able to flexibly respond.
- One facet of globalization that has proved relatively efficient in the last decade has been the ability of capital markets to recycle capital from current account surplus to current account deficit countries. The recent pressures on commodity prices may have tilted current account surpluses to high savings rate countries, thus dampening global demand pressures and weakening growth prospects in many industrial countries. Higher rates of unemployment inevitably put pressure on welfare states that critically depend on maintaining relatively high employment rates (e.g., the Nordic countries). 3. What policies enable countries to reap the benefits from globalization while providing minimum levels of economic security, necessary to keep the citizens from voting for strongly protectionist policies? There is a conventional wisdom now on at least some obvious elements of the desirable policy response to the forces of globalization. In some respects, these are the same policies which would appear appropriate in sustaining rapid growth in a globalized policy environment, though not all are likely to be perceived as “favorable” by those likely to be sympathetic to protectionist policies. These include: achieving greater flexibility in labor markets to facilitate the reallocation of labor across sectors (reduced employment protection provisions, less burdensome unemployment insurance taxes and less generous unemployment insurance benefit provisions); greater portability in pension benefits; health insurance not tied to employment provision; life long education and retraining initiatives; enhanced efforts at fostering job placement and mobility to areas of high employment



demand; policies that provide incentives for research and innovation; policies that foster enhanced investment in infrastructure, such as with respect to ITC; and policies that foster rapid adjustment of prices to market trends, facilitating adjustment by producers and factors of production. Having a basic social safety net – a combination of mean-tested welfare schemes and vigorous efforts at job retraining, placement, and possibly resettlement – may be a critical element of a package that limits support for protectionist policies.

### ***Points About Globalization and the Welfare State***

Assar Lindbeck

*Professor of International Economics, University of Stockholm*

In the media discussion, contemporary and expected future problems for welfare-state arrangements in developed countries are often blamed on the internationalization (globalization) process. In fact, however, the most serious problems for the welfare state are related to *domestic* economic and social trends in the developed countries themselves. Indeed,

the two most important challenges for welfare-state arrangements in developed countries are (i) the gradual rise, without apparent limit, of the relative costs of providing human services such as child care, education, health care and old-age care; and (ii) the implicit tax wedges in social-insurance arrangements and the related tendencies to moral hazard in the connection with these arrangements. Sooner or later it will, therefore, be necessary to partly shift to other sources than taxes to finance human services – basically insurance arrangements and/or direct service fees in cash. Otherwise it will be impossible to expand the production and consumption of such services in line with people's need and preferences.

In the media discussion, the demographic development is, of course, regarded as another major threat to the welfare state, in particular, the pension system. However, it is quite superficial to regard increased longevity as a "problem". It is rather the pension system itself that is the problem, since it has not been adjusted sufficiently to the increased longevity and the improved health of elderly. A higher effective retirement age is the obvious answer to the financial problems for the pension systems, to the extent these problems are created by increased longevity. Moreover, the rising costs for the national economy of health care and old-age care for the elderly have to be dealt with in the same way as the rising costs for human services to other population groups, i.e., by insurance arrangements and service fees.

Immigration of individuals in working age could also help to some (limited) extent – an example when globalization (in this case of the labor market) might be of some help for the welfare state. However, for such policies actually to increase the proportion between the working population and the retirees, it would be necessary to overhaul the systems of wage formation and jobs-security legislation so that immigrants could actually get jobs. Today, the organization of wage formation, and the labor market in general, is often quite inconsistent with large-scale immigration of labor.

What, then, are the challenges of globalization for the welfare state – in addition to the difficulties to integrate immigrants in the national labor market?

First, it is usually assumed that globalization will be accompanied by faster rates of structural change in developed countries, in particular in labor-intensive sectors. However, empirical studies suggest that structural change in developed countries, and related structural unemployment, is a consequence mainly of domestic conditions including policies in the developed countries themselves. Moreover, the situation seems to differ across developed countries. Countries geographically and culturally close to previous "Eastern Europe" may be harder hit



than other countries. But again, this may to a large extent be a result of domestic distortions, such as the unrealistically high real wages in former Eastern Germany. Again, rigidities in the domestic labor market (such as the insider-outsider divide), including domestic wage formation, is the problem, rather than the globalization process per se.

But suppose that structural unemployment actually tends to increase in the future. Regardless of the causes, this would probably strengthen the case for providing hiring subsidies, such “hiring vouchers”, for workers who have lost their jobs. However, it is hardly operational (or ethically reasonable) to limit such vouchers to individuals who are asserted to have lost their jobs because of globalization rather than because of some other reason outside the individual employee’s control.

The increased international mobility of various tax-bases is a second challenge of the ongoing globalization process for welfare-state. In particular, the high mobility of financial capital makes it difficult for national governments to redistribute income from the highest income percentiles, for which capital income is important, to lower percentiles. Indeed, these difficulties are illustrated by recent tendencies among countries to reduce capital income tax rates – and even to abolish wealth taxes in some countries. By contrast, so far, there is not much evidence of serious problems for developed countries in the connection with increased international mobility of highly educated individuals. However, in the long run this mobility is likely to put some limits on the possibility for individual countries to use highly progressive income taxes as a tool of redistributing labor income. In developing countries, international mobility of highly educated individual has, of course, for a long time created serious problems of “brain drain”.

The globalization process may have other consequences as well for the welfare state. For instance, the increased mobility of individuals across countries increases the usefulness of international portability of welfare-state entitlements – pensions as well as the availability of affordable health care. In a European context, EU is already involved in the creation of such portability within the European continent. One way of bringing about such portability would certainly be to rely more than earlier on personal accounts in the national entitlement systems.

*Note:* The points in this paper have been developed in more detail in papers found on my home page: <[iies.su.se/~assar/](http://iies.su.se/~assar/)>. Thereafter: Recent Work.

## **Strategy Perspectives**

Adam S. Posen

*Deputy Director, Peterson Institute*

In contrast to the commonly-held fears, economic efficiency and social equality are advancing together today when the engine of globalization is allowed to drive conditions. It is only the protectionist self-defense of lesser-skilled white males, the workers in the heavy older industries and self-employed in small businesses, that acts as a brake on this progress. Unfortunately, however, that self-defense has been very effective politically in the US, not least because of the skillful co-opting of the image of the middle-class by these reactionary forces to build support for efforts to limit economic change. Of course, the result of such protectionist efforts when successful is loss of national income to all Americans, and diminished opportunities for women, people of color, immigrants, and others who are not incumbents in the industries and businesses of old. So the policy challenge is to simultaneously build political support for the salutary economic changes to take place while preventing those losing relative status and security from blocking the process of globalization.



I would suggest four policy measures in this regard:

- **Strengthen the central government versus devolving power regionally.** As seen repeatedly in US history, adding veto points along local lines tends to reinforce reactionary policies. While central government power can be abused, it remains a necessary condition for the enforcement of economic liberalization and equal opportunity – as well as for revenue collection.
- **Make a commitment to providing universal access to necessary goods (such as health care) and not to equalizing income.** The lacking welfare state in the US and the expensive welfare states of Europe both tend to cause most economic distortion and generate the least general public support when they directly re-distribute income. It is both more efficient and equitable to ensure that all citizens receive affordable or paid access to the goods critical for a middle-class life.
- **Protect citizens not stakeholders (and certainly not specific companies).** This is the flip side of the previous point. Once a government accepts the ‘stakeholder’ principle, meaning the purported right of economic actors rather than markets to determine corporate outcomes, the government is inherently opposing change and privileging incumbent workers and owners versus broader society. There are cases where the market should not be the only factor at work, but these are regarding public interests of broad applicability (food and drug safety, environmental regulation) not specific outcomes. Corporate Social Responsibility and the like is a distraction at best.
- **Be honest about defined contribution pension plans/options.** One specific change at present causing great consternation in the US is the shift from defined benefit pensions from specific employers to defined contribution savings plans, especially given the lack of knowledge about investment among average working people. Ultimately, the defined contribution plan – if truly made portable between employers and transparent – will be much fairer and more secure than the previous system. But regulations and education must be put in place such that American workers contribute and diversify enough before they will be comfortable with the change. And only then will the reactionary white males who were the primary beneficiaries of the previous system lose this rallying point for their protections.